

Exhibit G

Auditor's Opinions and Financial Statements

**DISTRICT OF COLUMBIA
TEACHERS' RETIREMENT FUND**

Financial Statements and Schedules

September 30, 2001 and 2000

(With Independent Auditors' Report Thereon)

**DISTRICT OF COLUMBIA
TEACHERS' RETIREMENT FUND**

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2001 M Street, N.W.
Washington, D.C. 20036

Independent Auditors' Report

Board of Trustees
District of Columbia Teachers' Retirement Fund

We have audited the accompanying statements of net assets of the District of Columbia Teachers' Retirement Fund (the Fund), a Pension Trust Fund of the Government of the District of Columbia, as of September 30, 2001 and 2000, and the related statements of changes in net assets for the years then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in note 1, these financial statements only present the financial activity of the Fund and are not intended to present the financial position and results of operations of the District taken as a whole.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets of the District of Columbia Teachers' Retirement Fund as of September 30, 2001 and 2000, and the changes in its net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The information on schedules 1 and 2 is not a required part of the financial statements, but is supplementary information required by the Governmental Accounting Standards Board. We have applied to schedules 1 and 2 certain limited procedures prescribed by professional standards, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit this information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The information on schedules 3 through 5 is presented for the purposes of additional analysis and is not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion thereon.

KPMG LLP

December 28, 2001



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**DISTRICT OF COLUMBIA
TEACHERS' RETIREMENT FUND**

Statements of Net Assets
September 30, 2001 and 2000
(Dollars in thousands)

Assets	2001	2000
Equity in pooled investments under Master Trust Agreement, at fair value (note 4)	\$ 825,606	912,709
Accrued interest receivable	3,581	3,875
Benefit contributions receivable	1,349	1,300
Due from District of Columbia Government	—	1,018
Total assets	<u>830,536</u>	<u>918,902</u>
 Liabilities		
Liabilities under securities lending agreements	48,036	54,164
Accounts Payable – investment expense	571	673
Due to Federal Government	2,600	1,600
Due to District of Columbia Government	575	—
Total liabilities	<u>51,782</u>	<u>56,437</u>
Net Assets Held in Trust for Pension Benefits	<u>\$ 778,754</u>	<u>862,465</u>

See accompanying notes to financial statements.

**DISTRICT OF COLUMBIA
TEACHERS' RETIREMENT FUND**

Statements of Changes in Net Assets
Years ended September 30, 2001 and 2000
(Dollars in thousands)

	<u>2001</u>	<u>2000</u>
Additions:		
Contributions:		
District government	\$ 200	10,700
District employees	24,047	23,646
Total contributions	<u>24,247</u>	<u>34,346</u>
Investment income:		
Net appreciation (depreciation) in fair value of investments	(129,875)	78,536
Interest and dividends	31,112	28,896
	<u>(98,763)</u>	<u>107,432</u>
Less:		
Investment expenses	1,908	1,720
Interest expense on securities lending transactions	3,865	4,186
Net investment income (loss)	<u>(104,536)</u>	<u>101,526</u>
Total additions	<u>(80,289)</u>	<u>135,872</u>
Deductions:		
Benefit payments	2,600	1,600
Administrative expenses	822	775
Total deductions	<u>3,422</u>	<u>2,375</u>
Net (decrease) increase in net assets	<u>(83,711)</u>	<u>133,497</u>
Net assets held in trust for pension benefits:		
Beginning of year	<u>862,465</u>	<u>728,968</u>
End of year	<u>\$ 778,754</u>	<u>862,465</u>

**DISTRICT OF COLUMBIA
TEACHERS' RETIREMENT FUND**

Notes to Financial Statements

September 30, 2001 and 2000

(Dollars in thousands)

(1) Organization

The District of Columbia Teachers' Retirement Fund (the Fund) was established in 1979 by the District of Columbia Retirement Reform Act (the Reform Act, Pub. L. 96-122, D. C. Code § 1-701 et seq.). The Fund provides assets to pay pension benefits to all teachers employed by the Board of Education, including certain other educational employees in the public day schools and certain eligible educational employees in the public charter schools of the District of Columbia. The Reform Act also established the District of Columbia Retirement Board (the Board) and the District of Columbia Police Officers and Fire Fighters' Retirement Fund (the Police and Fire Fund).

The National Capital Revitalization and Self-Government Improvement Act of 1997 (the Revitalization Act, Title XI of the Balanced Budget Act of 1997, Pub. L. 105-33) transferred the District of Columbia Judges' Retirement Fund to the United States Federal Government (the Federal Government). The Revitalization Act also transferred significant assets and liabilities of the Fund and the Police Officers and Fire Fighters' Retirement Fund (collectively, the District Retirement Funds) to the Federal Government.

Concurrently, the District of Columbia Retirement Protection Act of 1997 (the Retirement Protection Act, Subtitle A of the Revitalization Act) transferred to the Federal Government the liability for retirement benefits for employee service credit earned prior to July 1, 1997, by participants of the District Retirement Funds. The assets transferred to the Federal Government and the assets of the District Retirement Funds managed by the Retirement Board are components of the same single employer defined benefit pension plans.

As required by the Retirement Protection Act, the Council of the District of Columbia (the Council) enacted the Police Officers, Fire Fighters, and Teachers Retirement Benefit Replacement Plan Act of 1998 (September 18, 1998, D.C. Law 12-152, § 101, 45 DCR 4045; D.C. Code § 1-901.01 et seq.). This Act (the Replacement Act) established the pension benefits for employee service provided after June 30, 1997, and provides for full funding of the benefits on an actuarially sound basis.

The Board is an independent agency of the District of Columbia Government (the District) that is responsible for managing the assets of the District Retirement Funds. Although the assets of the funds are commingled for investment purposes, each Fund's assets may only be used for the payment of benefits to the members of that Fund and certain administrative expenses.

The Fund is included in the District's Comprehensive Annual Financial Report as a pension trust fund.

**DISTRICT OF COLUMBIA
TEACHERS' RETIREMENT FUND**

Notes to Financial Statements

September 30, 2001 and 2000

(Dollars in thousands)

(2) Fund Administration and Description

(a) *District of Columbia Retirement Board*

The Board consists of 12 trustees, three appointed by the Mayor of the District, three appointed by the Council of the District, and six elected by the active and retired participants. Included are one active and one retired representative each from the police officers, firefighters, and teachers. The six employee representatives are elected by their respective groups of active and retired employees.

Since its inception, the Board has operated under a committee system which provides a two-tiered process for fiduciary review and analysis. In this manner, the Board, consistent with its fiduciary duties, thoroughly and comprehensively reviews all issues brought before it. The Board has six standing committees, including Benefits, Fiduciary, Investment, Legislative, Operations, and Minority Participation. To implement its policies, the Board retains the executive director and other staff to be responsible for the day-to-day management of the District Retirement Funds.

(b) *Other Administration*

The District Board of Education makes findings of fact, conclusions of law, and decisions regarding involuntary retirement, survivor benefits and annual medical and income reviews. The Office of Pay and Retirement Services (OPRS) within the D.C. Office of Financial Operations and Systems, Office of the Chief Financial Officer, receives retirement orders for retirement benefit calculations for all active plan members found eligible for retirement and carries out the day-to-day processing of retirement benefits. OPRS also processes employee requests for refunds of contributions.

**DISTRICT OF COLUMBIA
TEACHERS' RETIREMENT FUND**

Notes to Financial Statements

September 30, 2001 and 2000

(Dollars in thousands)

(c) Eligibility

Permanent, temporary and probationary teachers and certain other employees of the District of Columbia public day schools become members automatically on their date of employment. Substitute teachers and employees of the Department of School Attendance and Work Permits are not covered.

Title 38, Chapter 20 of the D.C. Official Code (D.C. Code § 38-2001.01 et seq. (2001 Ed.)) establishes benefit provisions which may be amended by the Council. For employees hired before November 16, 1996, the annuity is equal to the average salary, as defined, multiplied by 1.5% for each of the first five years of service, 1.75% for each of the second five years and 2% for each additional year. For employees hired on or after November 16, 1996, the annuity is equal to the average salary, as defined, multiplied by 2% for each year of service. The annuity may be further increased by crediting unused sick leave as of the date of retirement. Participants receive an annual benefit increase proportional to changes in the Consumer Price Index; however, the increase may not exceed 3% for participants hired on or after November 16, 1996.

Participants may select from among several survivor options. Participants who have 5 years of school service (work for the District of Columbia public school system), and who become disabled and can no longer perform their jobs satisfactorily, may be eligible for disability retirement. Disability benefits are calculated under a guaranteed minimum formula.

Optional retirement is available for teachers who have a minimum of 5 years of school service and who achieve the following age and length of service requirements:

- at age 62 with 5 years of service;
- at age 60 with 20 years of service; and
- at age 55 with 30 years of service;
- or at any age with 30 years of service, if hired by the school system on or after November 16, 1996.

Employees who are involuntarily separated other than for cause and who have five years of school service, may be eligible for retirement at any age with 25 years of service or at age 50 with 20 years of service. The annuity is reduced if at the time of its commencement the participant is under the age of 55.

**DISTRICT OF COLUMBIA
TEACHERS' RETIREMENT FUND**

Notes to Financial Statements

September 30, 2001 and 2000

(Dollars in thousands)

(d) Participant Data

For the years ended September 30, 2001 and 2000 the number of participating employees was as follows:

	<u>2001</u>	<u>2000</u>
Retirees and beneficiaries receiving benefits (includes retirees being paid by the Federal Government)	5,098	4,976
Terminated plan members entitled to but not yet receiving	25	25
Active vested plan members	4,663	4,943
Active nonvested plan members	<u>1,383</u>	<u>1,198</u>
Total	<u><u>11,169</u></u>	<u><u>11,142</u></u>

(e) Contributions

Fund members contribute by salary deductions at rates established by D.C. Code. Members contribute 7% (or 8% for teachers hired on or after November 16, 1996) of annual pay minus any pay received for summer school. Fund members may also contribute up to 10% of annual pay toward an annuity in addition to any vested pension.

The District is required to contribute the remaining amounts necessary to finance the coverage of its employees through annual contributions at actuarially determined amounts in accordance with the provisions of the Replacement Act. The District contributions for fiscal years 2001 and 2000 were equal to the Fund's independent actuary's recommendation.

Contribution requirements of the Fund members are established at D.C. Code § 38-2001.01 et seq. (2001 Ed.) and contribution requirements of the government of the District of Columbia are established at D.C. Code 1-907.02 (2001 Ed.). Contribution requirements may be amended by the Council. Administrative costs are financed through investment earnings.

(3) Summary of Significant Accounting Policies

(a) Basis of Accounting

The financial statements are prepared using the accrual basis of accounting. Employee contributions are recognized as compensation is earned by fund members. Employer contributions to the Fund are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of the Fund.

**DISTRICT OF COLUMBIA
TEACHERS' RETIREMENT FUND**

Notes to Financial Statements

September 30, 2001 and 2000

(Dollars in thousands)

(b) *Method Used to Value Investments*

Investments are reported at fair value, and reflect transaction costs, such as brokerage commissions and other costs normally incurred in a sale, if such costs are determinable. Short-term investments are reported at cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at the current exchange rate. Collateralized mortgage obligations are stated at fair value. The fair value of real estate investments is based on independent appraisals, when available, and the fair value of limited partnership interests in real estate investments is based on reported estimated fair values. Investments that do not have established market values are reported at estimated fair value.

(c) *Actuarial Data*

The Fund uses the Aggregate Actuarial Cost method to determine the annual contribution. The excess of the actuarial present value of projected benefits of the group included in an actuarial valuation over the sum of the actuarial value of assets and the actuarial present value of employee contributions is allocated on a level basis over the earnings or service of the group between the valuation date and assumed exit date. This allocation is performed for the group as a whole, not as a sum of individual allocations. That portion of the actuarial present value allocated to a valuation year is called the normal cost. The actuarial accrued liability is equal to the actuarial value of assets.

(d) *Use of Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires the Board to make estimates and assumptions that affect the reported amounts of assets, liabilities, additions and deductions to net assets held in trust for pension benefits and disclosure of contingent assets and liabilities at the date of the financial statements and during the reporting period. Actual results could differ from those estimates.

(e) *Investment Expenses*

The District of Columbia Appropriation Act authorized Fund earnings to be used for investment expenses incurred in managing the assets and administering the Fund. The total investment expenses borne by the Fund was \$1,908 and \$1,720 in 2001 and 2000, respectively.

(4) *Investments*

The Board is authorized to manage and control the investment of the District Retirement Funds' assets. The Board broadly diversifies the investments of the District Retirement Funds so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so, as required by D.C. Code § 1-741(a)(2)(C). The District Retirement Funds are authorized to be invested in a variety of investments including fixed income, equity securities and other types of investments. As prescribed in D.C. Code § 1-907.01 (2001 Ed.), the Board shall not invest in debt instruments of the District, the Commonwealth of Virginia or State of Maryland governments, political subdivisions thereof, or any entity subject to control by them; debt instruments fully guaranteed by those governments; real property in those jurisdictions; or debt instruments secured by real property in those jurisdictions.

**DISTRICT OF COLUMBIA
TEACHERS' RETIREMENT FUND**

Notes to Financial Statements

September 30, 2001 and 2000

(Dollars in thousands)

(a) Master Trust

The Board has pooled all of the assets under its management (the Investment Pool), as is authorized by D.C. Code § 1-903.03(b), (2001 Ed.), with a master custodian under a master trust arrangement (the Master Trust). Using an investment pool, each Fund has equity in the pool. District and employee contributions are deposited to the respective Retirement Fund for which the contribution was made, and benefit payments and employee contribution refunds are withdrawn from the Fund in which the recipient participates. Investment performance and administrative expenditures are allocated between the two Funds based upon their proportionate equity in the pool. The fair values of investments of the Investment Pool as of September 30, 2001 and 2000 are as follows:

	<u>2001</u>	<u>2000</u>
Investments categorized (A)		
Investments – held by Board’s agent in Board’s name:		
Cash and cash equivalents	\$ 472,435	309,719
Equities (of which \$0 and \$839 in 2001 and 2000, respectively, is on securities loan with securities and other collateral)	1,063,641	1,277,699
Fixed income securities (of which \$9,381 and \$1,347 in 2001 and 2000, respectively, is on securities loan with securities and other collateral)	645,862	682,162
Payable on investment transactions	<u>(422,100)</u>	<u>(356,256)</u>
Subtotal	<u>1,759,838</u>	<u>1,913,324</u>
Investments not categorized (B)		
Real estate	<u>4,877</u>	<u>5,295</u>
Investment held by broker-dealer under securities loans with cash collateral:		
Equities	38,235	46,148
Fixed income security	74,785	78,874
Securities lending collective investment pool	<u>115,813</u>	<u>129,091</u>
Subtotal	<u>228,833</u>	<u>254,113</u>
Total	<u>\$ 1,993,548</u>	<u>2,172,732</u>

(A) All categorized investment are Category 1 risk.

(B) These investment are not categorized because they are not evidenced by securities that exist in physical or book entry form.

**DISTRICT OF COLUMBIA
TEACHERS' RETIREMENT FUND**

Notes to Financial Statements

September 30, 2001 and 2000

(Dollars in thousands)

Investments are categorized by level of custodial credit risk (the risk that a counterparty to an investment transaction will not fulfill its obligations). Category 1, the lowest risk, includes investments that are insured or registered or for which the securities are held by the entity or its agent in the entity's name. Category 2 includes uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent in the entity's name. Category 3, the highest risk, includes uninsured and unregistered investments for which the securities are held by the counterparty, or by its trust department or agent, but not in the entity's name.

At September 30, 2001, the Fund's share of the Investment Pool was \$829,187, including cash collateral of \$48,036 and accrued interest receivable. At September 30, 2000, the Fund's share of the Investment Pool was \$916,584, including cash collateral of \$54,162 and accrued interest receivable.

(b) *Securities Lending Transactions*

District statutes and the Board's policies permit the District Retirement Funds to participate in securities lending transactions via a Securities Lending Authorization Agreement, which authorizes the master custodian to lend the Board's securities to qualified broker-dealers and banks pursuant to a form of loan agreement.

During 2001 and 2000, the master custodian, at the direction of the Board, lent the District Retirement Funds' equity and fixed income securities and received collateral in the form of cash (United States and foreign currency), securities issued or guaranteed by the United States government, the sovereign debt of Organization of Economic Cooperation and Development countries and irrevocable letters of credit issued by a bank insured by the FDIC. The collateral could not be pledged or sold unless the borrower defaulted on the loan. Borrowers delivered collateral for each loan equal to (i) at least 102% of the market value of the loaned securities if these securities were sovereign debt issued by a foreign government denominated in U.S. dollars or their primary trading market was located in the United States; or (ii) 105% of the market value of the loaned securities in the case of loaned securities not denominated in United States dollars or whose primary trading market was not located in the United States.

The Board and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other qualified tax-exempt plan lenders, in a collective investment pool (the Quality Fund). Because the Quality Fund does not meet the requirements of rule 2a-7 of the Investment Company Act of 1940, the master custodian has valued the Fund's investments at fair value for reporting purposes.

The Quality Fund is not registered with the Securities and Exchange Commission. The master custodian, and consequently the investment vehicles it sponsors (including the Quality Fund), are subject to the oversight of the Federal Reserve Board and the Massachusetts Commissioner of Banks. The fair value of the Fund's position in the Quality Fund is not the same as the value of the Retirement Funds' shares.

**DISTRICT OF COLUMBIA
TEACHERS' RETIREMENT FUND**

Notes to Financial Statements

September 30, 2001 and 2000

(Dollars in thousands)

There was no involuntary participation in an external investment pool by the Quality Fund and there was no income from one fund that was assigned to another fund by the master custodian during 2001 or 2000.

The average duration of the investment pool as of September 30, 2001 and 2000 was 74 days, and the average weighted maturity was 193 and 161 days, respectively. Because the loans were terminable at will, their duration did not generally match the duration of the investments made with cash collateral.

During 2001 and 2000, the Board did not restrict the amount of the loans that the master custodian made on its behalf. There were no failures by any borrowers to return loaned securities or pay distributions thereon and there were no losses resulting from a default of the borrowers or the master custodian during 2001 and 2000.

On September 30, 2001 and 2000, the Board had no credit risk exposure to borrowers. The collateral held and the market value of securities on loan for the Board were \$125,382 and \$122,402, respectively, as of September 30, 2001, and \$131,387 and \$127,207, respectively as of September 30, 2000. During 2001 and 2000, the Master Trust's gross earnings from securities lending transactions totaled \$9,433 and \$10,137, respectively. The income (net of amortization and accretion), the net realized/unrealized gain attributable to discount and premium, and the net increase in net assets resulting from operations totaled \$7,807, \$1,500, and \$9,306, respectively, in 2001, and \$8,326, \$1,573, and \$9,899, respectively, in 2000. The Fund's share of the net earnings on securities lending transactions totaled \$315 and \$214 in 2001 and 2000, respectively.

(c) *Derivative Investments*

Derivatives are generally defined as contracts whose value depends on, or *derives* from, the value of an underlying asset, reference rate, or index. Structured financial instruments are also defined as derivatives, such as mortgage-backed securities, asset-backed securities, and floating rate notes. Derivative investments generally contain exposure to credit risk, market risk, and/or legal risk. Credit risk is the exposure to the default of another party to the transaction (counterparty), or to the creditworthiness of derivative securities, such as mortgage-backed, asset-backed, floating rate, and stripped securities. Market risk is the exposure to changes in the market, such as a change in interest rates, currency exchange rates, or a change in the price or principal value of a security. The Board believes that all contracts entered into are legally permissible in accordance with the policy of the Board.

During 2001 and 2000, the Retirement Funds, in accordance with the policy of the Board, invested in various derivative instruments either to increase potential earnings or to hedge against potential losses. These derivatives included asset-backed securities (ABS), collateralized mortgage-backed securities (CMOs), mortgage-backed pools and securities, floating rate notes, structured notes, stripped/zero coupon bonds, inflation index bonds, forward mortgage-backed security contracts (TBAs), foreign currency forward and futures contracts, equity index futures, bond futures, bond options, currency options, and warrants.

**DISTRICT OF COLUMBIA
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Notes to Financial Statements

September 30, 2001 and 2000

(Dollars in thousands)

The Retirement Funds used ABS, CMOs, mortgage-backed pools and securities, floating rate notes, structured notes, stripped/zero coupon bonds, and TBAs primarily to increase potential returns. ABS and mortgage-backed pools and securities offer higher potential yields than comparable duration U. S. Treasury Notes with higher credit and market risks. CMOs also offer higher potential yields than comparable duration U.S. Treasury Notes, with higher market risks, although the market risks may be higher or lower than comparable mortgage-backed pools. Market risk for asset-backed and mortgage-backed pools and securities is managed by monitoring the duration of the investments. Credit risk is managed by monitoring credit ratings, the underlying collateral for each security and any related guarantee.

Floating rate notes (securities which pay an interest rate tied to an index) are subject to market risk to the extent of the movement of the underlying index in relation to market rates. A downward movement in the underlying index would negatively impact the interest income received on the security. Upward movements in interest rates do not adversely affect floating rate notes as they do fixed rate notes, allowing floating rate notes to function as a hedge against upward changes in interest rates.

The Retirement Funds invests in structured notes with step-up coupons that offer higher yields than comparable U.S. Treasury Notes in exchange for higher market and/or credit risks. Securities with step-up coupons pay interest according to a pre-set series of interest rates which start at one rate and then step-up to higher rates on specific dates. The Retirement Funds also contains stripped/zero coupon bonds, which are purchased at a discount and do not pay any interest.

TBAs are used by the Retirement Funds as an alternative to holding mortgage-backed securities outright to raise the potential yield and to reduce transaction costs. The TBAs used are assumed to be similar in duration and convexity to mortgage-backed securities with identical credit, coupon and maturity features. Credit risk is managed by limiting these transactions to primary dealers.

Market risk for this type of security is not significantly different from the market risk for mortgage-backed securities.

Foreign currency forward and futures contracts and foreign currency options are used by the Retirement Funds for defensive purposes. These contracts hedge a portion of the Retirement Funds' exposure to particular currencies on occasion when significant adverse short-term movement in exchange rate levels are expected. Foreign currency forward and futures contracts can pose market risk when the maximum potential loss on a particular contract is greater than the value of the underlying investment. Market risks arise due to movements in the foreign exchange rates underlying the contracts used by the Retirement Funds. Credit risk is managed by limiting transactions to counterparties with short-term credit ratings of A1 or P1 or by trading on organized exchanges. Market risk for currency options is limited to the purchase cost. Credit risk is managed by limiting transactions to counterparties with investment grade ratings or by trading on organized exchanges.

**DISTRICT OF COLUMBIA
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Notes to Financial Statements

September 30, 2001 and 2000

(Dollars in thousands)

Equity index futures are used in at least one of the commingled funds used by the Retirement Funds in order to gain exposure to U. S. equity markets in a more efficient and liquid manner than directly investing in all of the underlying equity securities. Equity index futures can pose market risk when the maximum potential loss on a particular contract is greater than the value of the underlying investment. Market risks arise due to movements in the equities markets underlying the contracts used by the Retirement Funds. Credit risk is managed by dealing with the futures exchanges.

Exchange-traded and over-the-counter bond futures and options are used by the Retirement Funds to gain exposure to fixed income markets in a more efficient and liquid manner than by purchasing the underlying bonds. Market risk for these options is limited to purchase cost. Credit risk is managed by limiting transactions to counterparties with investment grade ratings or by trading on organized exchanges.

Warrants are used by the Retirement Funds to gain equity exposure and to enhance performance. Warrants are often distributed by issuers to holdings of common stock and bonds, and are held for the same fundamental reasons as the original common stock and/or bond holdings. Market risk is limited to the purchase cost. Credit risk is similar to the underlying equity and/or bond holdings.

The Retirement Funds also holds derivative instruments indirectly by participating in pooled, commingled, mutual, or short-term funds that hold derivatives. Information regarding any risks associated with these holdings is not generally available.

The proportion of derivative investments in the Retirement Funds varies throughout the year. Further information regarding balances throughout the year is not available.

The Retirement Funds' aggregate portfolio included the following derivative investments, at fair value, at September 30, 2001 and 2000:

	<u>2001</u>	<u>2000</u>
Mortgage backed security pools and securities	\$ 45,123	31,023
Collateralized mortgaged obligations	21,672	11,455
Asset backed securities	71,872	56,069
Floating rate notes	—	11,581
Mortgage backed securities forward contracts	203,982	293,451
Inflation index bonds	—	29,954
Structured notes (including stripped securities)	3,377	15,183
Foreign currency futures/forward contracts, net	—	(6,528)
Stock performance index futures fund	85,270	18,345
Options	—	(2,754)
Total	<u>\$ 431,296</u>	<u>457,779</u>

**DISTRICT OF COLUMBIA
TEACHERS' RETIREMENT FUND**

Schedule of Employer Contributions

(Unaudited)

(Dollars in thousands)

	<u>Annual required contribution</u>	<u>Percentage contributed</u>
Fiscal year ended September 30:		
2001	\$ 200	100%
2000	10,700	100%
1999	18,600	100%
1998	9,700	100%

**DISTRICT OF COLUMBIA
TEACHERS' RETIREMENT FUND**

Schedule of Actuarial Methods and Assumptions

(Unaudited)

The information presented in the required supplementary schedules was determined as part of the actuarial valuations at the dates indicated. Additional information as of the latest actuarial valuations follows.

Valuation date	October 1, 1999
Actuarial cost method	Aggregate
Amortization method	Not applicable
Remaining amortization period	Not applicable
Asset valuation method	Market value
Actuarial assumptions:	
Investment rate of return	7.25%
Projected salary increase	5.3%-8.8%
Includes inflation at	7.25%
Cost-of-living adjustments (COLAs)	5%
(1) Post-1996 hires have COLAs capped at 3.00%	5% ⁽¹⁾

The aggregate actuarial cost method does not identify or separately amortize unfunded actuarial liabilities.

**DISTRICT OF COLUMBIA
TEACHERS' RETIREMENT FUND**

Schedule of Revenue by Source and Expenses by Type

Last Ten Fiscal Years

(Unaudited)

(Dollars in thousands)

Revenue by Source

	<u>Employee contributions</u>	<u>Employer contributions</u>	<u>Interest and dividends</u>	<u>Net appreciation (depreciation) in fair value of investments</u>	<u>Investment, Interest, and administrative expenses</u>	<u>Total</u>
Fiscal year:						
2001	\$ 24,047	200	31,112	(129,875)	(6,595)	(81,111)
2000	23,646	10,700	28,896	78,536	(6,681)	135,097
1999	21,537	18,600	26,573	105,295	(4,694)	167,311
1998	20,385	9,700	21,109	(9,756)	(3,915)	37,523
1997	19,405	88,100	65,682	363,256	(14,655)	521,788
1996	20,904	111,000	56,118	119,063	(4,691)	302,394
1995	23,564	87,100	51,014	161,434	(4,398)	318,714
1994	23,784	98,600	50,310	(7,216)	(4,202)	161,276
1993	21,375	98,800	46,169	117,472	(3,381)	280,435
1992	20,765	84,200	50,088	41,682	(3,833)	192,902

Expenses by Type

	<u>Benefits</u>	<u>Refunds</u>	<u>Total</u>
Fiscal year:			
2001	\$ 2,600	—	2,600
2000	1,600	—	1,600
1999	700	—	700
1998	200	479	679
1997	144,007	408	144,485
1996	134,803	1,175	135,978
1995	115,415	1,294	116,709
1994	110,620	1,471	112,091
1993	102,667	1,713	104,380
1992	97,533	1,315	98,848

Note: Contributions were made in accordance with actuarially determined contribution requirements.

The Revitalization Act of 1997 made significant changes to the administration of the Fund. Therefore, comparisons of pre-Revitalization Act information to post-Revitalization Act information may not be meaningful.

**DISTRICT OF COLUMBIA
TEACHERS' RETIREMENT FUND**

Schedule of Investment Information

Year ended September 30, 2001

(Unaudited)

At September 30, 2001, the Fund's investments were maintained under a master trust agreement along with assets of the District of Columbia Police Officers and Fire Fighters' Retirement Fund. A schedule of investments held under the master trust agreement at September 30, 2001 is available for inspection at the offices of the District of Columbia Retirement Board, Suite 300, 1400 L Street, N.W., Washington, D.C. 20005.

**DISTRICT OF COLUMBIA
TEACHERS' RETIREMENT FUND**

Schedule of Five Percent Reportable Series of Transactions

Year ended September 30, 2001

(Unaudited)

Each transaction with State Street Bank and Trust Company as disclosed in this schedule represents a "reportable transaction" as that term is defined by D.C. Code § 1-903.06(b)(3), (2001 Ed.).

**DISTRICT OF COLUMBIA
POLICE OFFICERS AND FIRE FIGHTERS'
RETIREMENT FUND**

Financial Statements and Schedules

September 30, 2001 and 2000

(With Independent Auditors' Report Thereon)

**DISTRICT OF COLUMBIA
POLICE OFFICERS AND FIRE FIGHTERS'
RETIREMENT FUND**

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2001 M Street, N.W.
Washington, D.C. 20036

Independent Auditors' Report

Board of Trustees
District of Columbia Police Officers and Fire Fighters' Retirement Fund:

We have audited the accompanying statements of net assets of the District of Columbia Police Officers and Fire Fighters' Retirement Fund (the Fund), a pension trust fund of the Government of the District of Columbia (the District), as of September 30, 2001 and 2000, and the related statements of changes in net assets for the years then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in note 1, the financial statements only present the financial activity of the Fund and are not intended to present the financial position and results of information of the District taken as a whole.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets of the District of Columbia Police Officers and Fire Fighters' Retirement Fund as of September 30, 2001 and 2000, and the changes in its net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The information on schedules 1 and 2 is not a required part of the financial statements, but is supplementary information required by the Governmental Accounting Standards Board. We have applied to schedules 1 and 2 certain limited procedures prescribed by professional standards, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit this information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The information on schedules 3 through 5 is presented for the purposes of additional analysis and is not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion thereon.

KPMG LLP

December 28, 2001



KPMG LLP, KPMG LLP, a U.S. limited liability partnership, is a member of KPMG International, a Swiss association.

**DISTRICT OF COLUMBIA
POLICE OFFICERS AND FIRE FIGHTERS'
RETIREMENT FUND**

Statements of Net Assets

September 30, 2001 and 2000

(Dollars in thousands)

Assets	2001	2000
Equity in pooled investments under Master Trust Agreement, at fair value (note 4)	\$ 1,159,327	1,250,857
Accrued interest receivable	5,034	5,291
Benefit contributions receivable	982	956
Total assets	<u>1,165,343</u>	<u>1,257,104</u>
 Liabilities		
Liabilities under securities lending agreements	67,777	74,927
Accounts payable – investment expenses	802	776
Due to Federal Government	2,000	2,200
Due to District of Columbia Government	943	190
Total liabilities	<u>71,522</u>	<u>78,093</u>
Net Assets Held in Trust for Pension Benefits	<u>\$ 1,093,821</u>	<u>1,179,011</u>

See accompanying notes to financial statements.

**DISTRICT OF COLUMBIA
POLICE OFFICERS AND FIRE FIGHTERS'
RETIREMENT FUND**

Statements of Changes in Net Assets
Years ended September 30, 2001 and 2000
(Dollars in thousands)

	<u>2001</u>	<u>2000</u>
Additions:		
Contributions:		
District government	\$ 49,000	39,900
District employees	16,832	16,285
Total contributions	<u>65,832</u>	<u>56,185</u>
Investment income:		
Net appreciation (depreciation) in fair value of investments	(182,944)	110,614
Interest and dividends	44,214	39,243
	<u>(138,730)</u>	<u>149,857</u>
Less:		
Investment expenses	2,858	2,234
Interest expense on securities lending transactions	5,435	5,630
Net investment income (loss)	<u>(147,023)</u>	<u>141,993</u>
Total additions	<u>(81,191)</u>	<u>198,178</u>
Deductions:		
Benefit payments	2,838	2,200
Administrative expenses	1,161	1,073
Total deductions	<u>3,999</u>	<u>3,273</u>
Net (decrease) increase in net assets	<u>(85,190)</u>	<u>194,905</u>
Net assets held in trust for pension benefits:		
Beginning of year	<u>1,179,011</u>	<u>984,106</u>
End of year	<u>\$ 1,093,821</u>	<u>1,179,011</u>

See accompanying notes to financial statements.

**DISTRICT OF COLUMBIA
POLICE OFFICERS AND FIRE FIGHTERS'
RETIREMENT FUND**

Notes to Financial Statements

September 30, 2001 and 2000

(Dollars in thousands)

(1) Organization

The District of Columbia Police Officers and Fire Fighters' Retirement Fund (the Fund) was established in 1979 by the District of Columbia Retirement Reform Act (the Reform Act, Pub. L. 96-122, D. C. Code § 1-701 et seq.). The Fund provides assets to pay pension benefits to police officers and fire fighters in the District. The Reform Act also established the District of Columbia Retirement Board (the Board) and the District of Columbia Teachers' Retirement Fund (the Teachers' Fund).

The National Capital Revitalization and Self-Government Improvement Act of 1997 (the Revitalization Act, Title XI of the Balanced Budget Act of 1997, Pub. L. 105-33) transferred the District of Columbia Judges' Retirement Fund to the United States Federal Government (the Federal Government). The Revitalization Act also transferred significant assets and liabilities of the Fund and the Teachers' Retirement Fund (collectively, the District Retirement Funds) to the Federal Government.

Concurrently, the District of Columbia Retirement Protection Act of 1997 (the Retirement Protection Act, Subtitle A of the Revitalization Act) transferred to the Federal Government the liability for retirement benefits for employee service credit earned prior to July 1, 1997, by participants of the District Retirement Funds. The assets transferred to the Federal Government and the assets of the District Retirement Funds managed by the Retirement Board are components of the same single employer defined benefit pension plan.

As required by the Retirement Protection Act, the Council of the District of Columbia (the Council) enacted the Police Officers, Fire Fighters, and Teachers Retirement Benefit Replacement Plan Act of 1998 (September 18, 1998, D.C. Law 12-152, § 101, 45 DCR 4045; D.C. Code § 1-901.01 et seq.). This Act (the Replacement Act) established the pension benefits for employee service provided after June 30, 1997, and provides for full funding of the benefits on an actuarially sound basis.

The Board is an independent agency of the District of Columbia Government (the District) that is responsible for managing the assets of the District Retirement Funds. Although the assets of the funds are commingled for investment purposes, each Fund's assets may only be used for the payment of benefits to the members of that Fund and certain administrative expenses.

The Fund is included in the District's Comprehensive Annual Financial Report as a pension trust fund.

**DISTRICT OF COLUMBIA
POLICE OFFICERS AND FIRE FIGHTERS'
RETIREMENT FUND**

Notes to Financial Statements

September 30, 2001 and 2000

(Dollars in thousands)

(2) Fund Administration and Description

District of Columbia Retirement Board

The Board consists of 12 trustees, three appointed by the Mayor of the District, three appointed by the Council of the District, and six elected by the active and retired participants. Included are one active and one retired representative each from the police officers, firefighters, and teachers. The six employee representatives are elected by their respective groups of active and retired employees.

Since its inception, the Board has operated under a committee system which provides a two-tiered process for fiduciary review and analysis. In this manner, the Board, consistent with its fiduciary duties, thoroughly and comprehensively reviews all issues brought before it. The Board has six standing committees, including Benefits, Fiduciary, Investment, Legislative, Operations, and Minority Participation. To implement its policies, the Board retains the executive director and other staff to be responsible for the day-to-day management of the District Retirement Funds.

Other Administration

The District of Columbia Police Officers and Fire Fighters' Retirement Relief Board makes findings of fact, conclusions of law, and decisions regarding retirement, survivor benefits, extent of disability, and annual medical and income reviews. The Board of Police and Fire Surgeons determines medical eligibility for disability retirement. The Office of Pay and Retirement Services (OPRS) within the D. C. Office of Financial Operations and Systems, Office of the Chief Financial Officer, receives retirement orders for retirement benefit calculations for all active plan members found eligible for retirement and carries out the day-to-day processing of retirement benefits. OPRS also processes employee requests for refunds of contributions.

Eligibility

A participant becomes a member when he/she starts work as a police officer or fire fighter in the District. Police cadets are not eligible to join the Fund.

Retirement and disability benefit provisions for District of Columbia police officers and fire fighters are established by the "Policemen and Firemen's Retirement and Disability Act," codified at D.C. Code § 5-701 et seq. (2001 Ed.).

**DISTRICT OF COLUMBIA
POLICE OFFICERS AND FIRE FIGHTERS'
RETIREMENT FUND**

Notes to Financial Statements

September 30, 2001 and 2000

(Dollars in thousands)

Members Hired Before February 15, 1980

Members are eligible for optional retirement with full benefits at any age with 20 years of departmental service, or after age 55 with five years of departmental service. The annual basic retirement benefit equals 2.5% of average pay, which is defined as the highest consecutive 12 months of departmental service, multiplied by departmental service up to 20 years, plus 3% of average pay multiplied by departmental service over 20 years, plus 2.5% of average pay multiplied by credited service, but not more than 80% of the average pay. Members terminated after five years of police or fire service are entitled to a deferred pension beginning at age 55. Benefits are also provided to certain survivors of active, retired, or terminated vested members. Members receive the per centum increase granted to active participants in the schedule rate to which the member would be entitled if in active service.

Members with permanent, service-related disabilities who have less than 26 years and eight months of service receive two-thirds (2/3) of average pay. Members with 26 years and eight months to 28 years of service receive 2.5% of average pay multiplied by service. Members with more than 28 years of service receive 70% of average pay.

Members with permanent, nonservice related disabilities who have 5 to 20 years of service receive 40% of average pay, 20 to 35 years of service receive 2% of average pay multiplied by service and more than 35 years of service receive 70% of average pay.

Members Hired Between February 15, 1980 and November 10, 1996

Members are eligible for optional retirement with full benefits at age 50 with at least 25 years of departmental service, or after 55 with five years of departmental service. The annual basic retirement benefit equals 2.5% of average pay, which is defined as the highest consecutive 36 months of departmental service, multiplied by departmental service up to 25 years, plus 3% of average pay multiplied by departmental service over 25 years plus, 2.5% of average pay multiplied by credited service, but not more than 80% of the average pay. Members separated after five years of departmental service are entitled to a deferred pension beginning at age 55.

Members with permanent, service-related disabilities receive 70% of final pay multiplied by percentage of disability, with a minimum benefit of 40% of final pay.

Members with permanent, nonservice related disabilities with more than 5 years of service receive 70% of final pay multiplied by percentage of disability, with a minimum benefit of 30% of final pay.

Benefits are also provided to certain survivors of active, retired or terminated vested members. Members retired after February 15, 1980 receive annual benefit increases proportional to changes in the Consumer Price Index.

**DISTRICT OF COLUMBIA
POLICE OFFICERS AND FIRE FIGHTERS'
RETIREMENT FUND**

Notes to Financial Statements

September 30, 2001 and 2000

(Dollars in thousands)

Members Hired on or After November 10, 1996

Members are eligible for retirement at any age, with at least 25 years of departmental service or after age 55 with five years of departmental service. The annual basic retirement benefit equals 2.5% of average pay, which is defined as the highest consecutive 36 months of departmental service, multiplied by departmental service, but not more than 80% of the average pay. Members separated after five years of departmental service are entitled to a deferred pension beginning at age 55. Benefits are also provided to certain survivors of active, retired, or terminated vested members. Members receive annual benefit increases proportional to changes in the Consumer Price Index, but not more than 3%.

Members with permanent, service-related disabilities receive 70% of final pay multiplied by percentage of disability, with a minimum benefit of 40% of final pay.

Members with permanent, nonservice related disabilities with more than five years of service receive 70% of final pay multiplied by percentage of disability, with a minimum benefit of 30% of final pay.

Participant Data

For the years ended September 30, 2001 and 2000, the number of participating employees was as follows:

	<u>2001</u>	<u>2000</u>
Retirees and beneficiaries receiving benefits (includes retirees being paid by the Federal Government)	7,614	7,547
Active plan members	4,091	4,140
Active nonvested plan members	624	646
Total	<u>12,329</u>	<u>12,333</u>

Contributions

Fund members contribute by salary deductions at rates established by D.C. Code § 5-706 (2001 Ed.). Members contribute 7% (or 8% for Police Officers and Fire Fighters hired on or after November 10, 1996) of annual salary, including any differential for special assignment, but excluding overtime, longevity, holiday, or military pay.

The District is required to contribute the remaining amounts necessary to finance the coverage of its employees through annual contributions at actuarially determined amounts in accordance with the provisions of the Replacement Act. The District contributions for fiscal years 2001 and 2000 were equal to the Fund's independent actuary's recommendation.

Contribution requirements of Fund members are established by D.C. Code § 5-706 and requirements for District of Columbia government contributions to the Fund are established at D.C. Code § 1-907.02 (2001 Ed.), which may be amended by the council. Administrative costs are financed through investment earnings.

**DISTRICT OF COLUMBIA
POLICE OFFICERS AND FIRE FIGHTERS'
RETIREMENT FUND**

Notes to Financial Statements

September 30, 2001 and 2000

(Dollars in thousands)

(3) Summary of Significant Accounting Policies

Basis of Accounting

The financial statements are prepared using the accrual basis of accounting where the measurement focus is on the flow of economic resources. Employee contributions are recognized as compensation is earned by fund members. Employer contributions to the Fund are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of the Fund.

Method Used to Value Investments

Investments are reported at fair value, and reflect transaction costs, such as brokerage commissions and other costs normally incurred in a sale, if such costs are determinable. Short-term investments are reported at cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at the current exchange rate. Collateralized mortgage obligations are stated at fair value. The fair value of real estate investments is based on independent appraisals, when available, and the fair value of limited partnership interests in real estate investments is based on reported estimated fair values. Investments that do not have established market values are reported at estimated fair value.

Actuarial Data

The Fund uses the Aggregate Actuarial Cost method to determine the annual contribution. The excess of the actuarial present value of projected benefits of the group included in an actuarial valuation over the sum of the actuarial value of assets and the actuarial present value of employee contributions is allocated on a level basis over the earnings or service of the group between the valuation date and assumed exit date. This allocation is performed for the group as a whole, not as a sum of individual allocations. That portion of the actuarial present value allocated to a valuation year is called the normal cost. The actuarial accrued liability is equal to the actuarial value of assets.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires the Board to make estimates and assumptions that affect the reported amounts of assets, liabilities, additions and deductions to net assets held in trust for pension benefits and disclosure of contingent assets and liabilities at the date of the financial statements and during the reporting period. Actual results could differ from those estimates.

Investment Expenses

The District of Columbia Appropriation Act authorized Fund earnings to be used for investment expenses incurred in managing the assets and administering the Fund. The total investment expenses borne by the Fund was and \$2,858 in 2001 and \$2,234 in 2000, respectively.

**DISTRICT OF COLUMBIA
POLICE OFFICERS AND FIRE FIGHTERS'
RETIREMENT FUND**

Notes to Financial Statements

September 30, 2001 and 2000

(Dollars in thousands)

(4) Investments

The Board is authorized to manage and control the investment of the District Retirement Funds' assets. The Board broadly diversifies the investments of the District Retirement Funds so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so, as required by D.C. Code § 1-741(a)(2)(C), (2001 Ed.). The District Retirement Funds are authorized to be invested in a variety of investments including fixed income, equity securities and other types of investments. As prescribed in D.C. Code § 1-907.01 (2001 Ed.), the Board shall not invest in debt instruments of the District, the Commonwealth of Virginia or State of Maryland governments, political subdivisions thereof, or any entity subject to control by them; debt instruments fully guaranteed by those governments; real property in those jurisdictions; or debt instruments secured by real property in those jurisdictions.

Master Trust

The Board has pooled all of the assets under its management (the Investment Pool), as is authorized by D.C. Code § 1-903(b), (2001 Ed.), with a master custodian under a master trust arrangement (the Master Trust). Using an investment pool, each Fund has equity in the pool. District and employee contributions are deposited to the respective Retirement Fund for which the contribution was made, and benefit payments and employee contribution refunds are withdrawn from the Fund in which the recipient participates. Investment performance and administrative expenditures are allocated between the two Funds based upon their proportionate equity in the pool. The fair values of investments of the Investment Pool as of September 30, 2001 and 2000 are as follows:

**DISTRICT OF COLUMBIA
POLICE OFFICERS AND FIRE FIGHTERS'
RETIREMENT FUND**

Notes to Financial Statements

September 30, 2001 and 2000

(Dollars in thousands)

	<u>2001</u>	<u>2000</u>
Investments categorized (A):		
Investments – held by Board’s agent in Board’s name:		
Cash and cash equivalents	\$ 472,435	309,719
Equities (of which \$0 and \$839 in 2001 and 2000, respectively, is on securities loan with securities and other collateral)	1,063,641	1,277,699
Fixed income securities (of which \$9,381 and \$1,347 in 2001 and 2000, respectively, is on securities loan with securities and other collateral)	645,862	682,162
Payable on investment transactions	<u>(422,100)</u>	<u>(356,256)</u>
Subtotal	<u>1,759,838</u>	<u>1,913,324</u>
Investments not categorized (B):		
Real Estate	<u>4,877</u>	<u>5,295</u>
Investments held by broker-dealer under securities loans with cash collateral:		
Equities	38,235	46,148
Fixed income security	74,785	78,874
Securities lending collective investment pool	<u>115,813</u>	<u>129,091</u>
Subtotal	<u>228,833</u>	<u>254,113</u>
Total	<u>\$ 1,993,548</u>	<u>2,172,732</u>

(A) All categorized investments are Category 1 risk.

(B) These investments are not categorized because they are not evidenced by securities that exist in physical or book entry form.

**DISTRICT OF COLUMBIA
POLICE OFFICERS AND FIRE FIGHTERS'
RETIREMENT FUND**

Notes to Financial Statements

September 30, 2001 and 2000

(Dollars in thousands)

Investments are categorized by level of custodial credit risk (the risk that a counterparty to an investment transaction will not fulfill its obligations). Category 1, the lowest risk, includes investments that are insured or registered or for which the securities are held by the entity or its agent in the entity's name. Category 2 includes uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent in the entity's name. Category 3, the highest risk, includes uninsured and unregistered investments for which the securities are held by the counterparty, or by its trust department or agent, but not in the entity's name.

At September 30, 2001, the Fund's share of the Investment Pool was \$1,164,361, including cash collateral of \$67,777 and accrued interest receivable. At September 30, 2000, the Fund's share of the Investment Pool was \$1,256,148, including cash collateral of \$74,927 and accrued interest receivable.

Securities Lending Transactions

District statutes and the Board's policies permit the Retirement Funds to participate in securities lending transactions via a Securities Lending Authorization Agreement, which authorizes the master custodian to lend the Board's securities to qualified broker-dealers and banks pursuant to a form of loan agreement.

During 2001 and 2000, the master custodian, at the direction of the Board, lent the Retirement Funds' equity and fixed income securities and received collateral in the form of cash (United States and foreign currency), securities issued or guaranteed by the United States government, the sovereign debt of Organization of Economic Cooperation and Development countries and irrevocable letters of credit issued by a bank insured by the FDIC. The collateral could not be pledged or sold unless the borrower defaulted on the loan. Borrowers delivered collateral for each loan equal to (i) at least 102% of the market value of the loaned securities if these securities were sovereign debt issued by a foreign government denominated in U.S. dollars or their primary trading market was located in the United States; or (ii) 105% of the market value of the loaned securities in the case of loaned securities not denominated in United States dollars or whose primary trading market was not located in the United States.

The Board and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other qualified tax-exempt plan lenders, in a collective investment pool (the Quality Fund).

Because the Quality Fund does not meet the requirements of rule 2a-7 of the Investment Company Act of 1940, the master custodian has valued the Fund's investments at fair value for reporting purposes.

The Quality Fund is not registered with the Securities and Exchange Commission. The master custodian, and consequently the investment vehicles it sponsors (including the Quality Fund), are subject to the oversight of the Federal Reserve Board and the Massachusetts Commissioner of Banks. The fair value of the Funds' position in the Quality Fund is not the same as the value of the Retirement Funds' shares.

There was no involuntary participation in an external investment pool by the Quality Fund and there was no income from one fund that was assigned to another fund by the master custodian during 2001 or 2000.

**DISTRICT OF COLUMBIA
POLICE OFFICERS AND FIRE FIGHTERS'
RETIREMENT FUND**

Notes to Financial Statements

September 30, 2001 and 2000

(Dollars in thousands)

The average duration of the investment pool as of both September 30, 2001 and 2000 was 74 days, and the average weighted maturity was 193 and 161 days, respectively. Because the loans were terminable at will, their duration did not generally match the duration of the investments made with cash collateral.

During 2001 and 2000, the Board did not restrict the amount of the loans that the master custodian made on its behalf. There were no failures by any borrowers to return loaned securities or pay distributions thereon and there were no losses resulting from a default of the borrowers or the master custodian during 2001 and 2000.

On September 30, 2001 and 2000, the Board had no credit risk exposure to borrowers. The collateral held and the market value of securities on loan for the Board were \$125,382 and \$122,402, respectively, as of September 30, 2001, and \$131,387 and \$127,207, respectively as of September 30, 2000. During 2001 and 2000, the Master Trust's gross earnings from securities lending transactions totaled \$9,433 and \$10,137, respectively. The income (net of amortization and accretion), the net realized/unrealized gain attributable to discount and premium, and the net increase in net assets resulting from operations totaled \$7,807, \$1,500, and \$9,306, respectively, in 2001, and \$8,326, \$1,573, and \$9,899, respectively, in 2000. The Fund's share of the net earnings on securities lending transactions totaled \$444 and \$296 in 2001 and 2000, respectively.

Derivative Investments

Derivatives are generally defined as contracts whose value depends on, or derives from, the value of an underlying asset, reference rate, or index. Structured financial instruments are also defined as derivatives, such as mortgage-backed securities, asset-backed securities, and floating rate notes. Derivative investments generally contain exposure to credit risk, market risk, and/or legal risk. Credit risk is the exposure to the default of another party to the transaction (counterparty), or to the creditworthiness of derivative securities, such as mortgage-backed, asset-backed, floating rate, and stripped securities. Market risk is the exposure to changes in the market, such as a change in interest rates, currency exchange rates, or a change in the price or principal value of a security. The Board believes that all contracts entered into are legally permissible in accordance with the policy of the Board.

During 2001 and 2000, the Retirement Funds, in accordance with the policy of the Board, invested in various derivative instruments either to increase potential earnings or to hedge against potential losses. These derivatives included asset-backed securities (ABS), collateralized mortgage-backed securities (CMOs), mortgage-backed pools and securities, floating rate notes, structured notes, stripped/zero coupon bonds, inflation index bonds, forward mortgage-backed security contracts (TBAs), foreign currency forward and futures contracts, equity index futures, bond futures, bond options, currency options, and warrants.

**DISTRICT OF COLUMBIA
POLICE OFFICERS AND FIRE FIGHTERS'
RETIREMENT FUND**

Notes to Financial Statements

September 30, 2001 and 2000

(Dollars in thousands)

The Retirement Funds used ABS, CMOs, mortgage-backed pools and securities, floating rate notes, structured notes, stripped/zero coupon bonds, and TBAs primarily to increase potential returns. ABS and mortgage-backed pools and securities offer higher potential yields than comparable duration U. S. Treasury Notes with higher credit and market risks. CMOs also offer higher potential yields than comparable duration U. S. Treasury Notes, with higher market risks, although the market risks may be higher or lower than comparable mortgage-backed pools. Market risk for asset-backed and mortgage-backed pools and securities is managed by monitoring the duration of the investments. Credit risk is managed by monitoring credit ratings, the underlying collateral for each security and any related guarantee.

Floating rate notes (securities which pay an interest rate tied to an index) are subject to market risk to the extent of the movement of the underlying index in relation to market rates. A downward movement in the underlying index would negatively impact the interest income received on the security. Upward movements in interest rates do not adversely affect floating rate notes as they do fixed rate notes, allowing floating rate notes to function as a hedge against upward changes in interest rates.

The Retirement Funds invest in structured notes with step-up coupons that offer higher yields than comparable U.S. Treasury Notes in exchange for higher market and/or credit risks. Securities with step-up coupons pay interest according to a pre-set series of interest rates which start at one rate and then step-up to higher rates on specific dates. The Retirement Funds also contain stripped/zero coupon bonds, which are purchased at a discount and do not pay any interest.

TBAs are used by the Retirement Funds as an alternative to holding mortgage-backed securities outright to raise the potential yield and to reduce transaction costs. The TBAs used are assumed to be similar in duration and convexity to mortgage-backed securities with identical credit, coupon and maturity features. Credit risk is managed by limiting these transactions to primary dealers. Market risk for this type of security is not significantly different from the market risk for mortgage-backed securities.

Foreign currency forward and futures contracts and foreign currency options are used by the Retirement Funds for defensive purposes. These contracts hedge a portion of the Retirement Funds' exposure to particular currencies on occasion when significant adverse short-term movement in exchange rate levels are expected. Foreign currency forward and futures contracts can pose market risk when the maximum potential loss on a particular contract is greater than the value of the underlying investment. Market risks arise due to movements in the foreign exchange rates underlying the contracts used by the Retirement Funds. Credit risk is managed by limiting transactions to counterparties with short-term credit ratings of A1 or P1 or by trading on organized exchanges. Market risk for currency options is limited to the purchase cost. Credit risk is managed by limiting transactions to counterparties with investment grade ratings or by trading on organized exchanges.

**DISTRICT OF COLUMBIA
POLICE OFFICERS AND FIRE FIGHTERS'
RETIREMENT FUND**

Notes to Financial Statements

September 30, 2001 and 2000

(Dollars in thousands)

Equity index futures are used in at least one of the commingled funds used by the Retirement Funds in order to gain exposure to U. S. equity markets in a more efficient and liquid manner than directly investing in all of the underlying equity securities. Equity index futures can pose market risk when the maximum potential loss on a particular contract is greater than the value of the underlying investment. Market risks arise due to movements in the equities markets underlying the contracts used by the Retirement Funds. Credit risk is managed by dealing with the futures exchanges.

Exchange-traded and over-the-counter bond futures and options are used by the Retirement Funds to gain exposure to fixed income markets in a more efficient and liquid manner than by purchasing the underlying bonds. Market risk for these options is limited to purchase cost. Credit risk is managed by limiting transactions to counterparties with investment grade ratings or by trading on organized exchanges.

Warrants are used by the Retirement Funds to gain equity exposure and to enhance performance. Warrants are often distributed by issuers to holdings of common stock and bonds, and are held for the same fundamental reasons as the original common stock and/or bond holdings. Market risk is limited to the purchase cost. Credit risk is similar to the underlying equity and/or bond holdings.

The Retirement Funds also holds derivative instruments indirectly by participating in pooled, commingled, mutual, or short-term funds that hold derivatives. Information regarding any risks associated with these holdings is not generally available.

The proportion of derivative investment in the Retirement Funds varies throughout the year. Further information regarding balances throughout the year is not available.

The Fund's aggregate portfolio included the following derivative investments, at fair value, at September 30, 2001 and 2000:

	<u>2001</u>	<u>2000</u>
Mortgage backed security pools and securities	\$ 45,123	31,023
Collateralized mortgage obligations	21,672	11,455
Asset backed securities	71,872	56,069
Floating rate notes	—	11,581
Mortgage backed securities forward contracts	203,982	293,451
Inflation index bonds	—	29,954
Structured notes (including stripped securities)	3,377	15,183
Foreign currency futures/forward contracts, net	—	(6,528)
Stock performance index futures fund	85,270	18,345
Options	—	(2,754)
Total	<u>\$ 431,296</u>	<u>457,779</u>

**DISTRICT OF COLUMBIA
POLICE OFFICERS AND FIRE FIGHTERS'
RETIREMENT FUND**

Schedule of Employer Contributions

(Unaudited)

(Dollars in thousands)

Fiscal Year	Annual required contribution	Percentage contributed
2001	\$ 49,000	100%
2000	39,900	100%
1999	35,100	100%
1998	47,700	100%

**DISTRICT OF COLUMBIA
POLICE OFFICERS AND FIRE FIGHTERS'
RETIREMENT FUND**

Schedule of Actuarial Methods and Assumptions
(Unaudited)

The information presented in the required supplementary schedules was determined as part of the actuarial valuations at the dates indicated. Additional information as of the latest actuarial valuation follows.

	<u>September 30, 2001</u>
Valuation date	October 1, 1999
Actuarial cost method	Aggregate
Amortization method	Not applicable
Remaining amortization period	Not applicable
Asset valuation method	Market value
Actuarial assumptions:	
Investment rate of return	7.25%
Projected salary increases	5.5%-8.8%
Includes inflation at	5%
Cost-of-living adjustments (COLAs)	5% ⁽¹⁾
(1) Post-1996 hires have COLAs capped at 3.00%	

The aggregate actuarial cost method does not identify or separately amortize unfunded actuarial liabilities.

**DISTRICT OF COLUMBIA
POLICE OFFICERS AND FIRE FIGHTERS'
RETIREMENT FUND**

Schedule of Revenue by Source and Expenses by Type

Last Ten Fiscal Years

(Unaudited)

(Dollars in thousands)

Revenue by source

Fiscal year		Employee contributions	Employer contributions	Interest and dividends	Net appreciation (depreciation) in fair value of investments	Investment, interest and administrative expenses	Total
2001	\$	16,832	49,000	44,214	(182,944)	(9,454)	(82,352)
2000		16,285	39,900	39,243	110,614	(8,937)	197,105
1999		15,736	35,100	29,765	84,694	(6,819)	158,476
1998		14,953	47,700	29,756	(13,806)	(5,399)	73,204
1997		13,796	226,700	96,368	510,240	(20,618)	826,486
1996		13,005	220,000	81,108	159,723	(6,304)	467,532
1995		13,616	204,900	77,096	211,940	(5,802)	501,750
1994		15,180	202,800	73,581	(9,300)	(5,464)	276,797
1993		14,067	188,200	60,728	151,520	(4,312)	410,203
1992		13,901	165,800	70,207	51,080	(4,701)	296,287

Expenses by type

Fiscal year		Benefits	Refunds	Total
2001	\$	2,838	—	2,838
2000		2,200	—	2,200
1999		1,600	—	1,600
1998		400	75	475
1997		240,836	162	240,998
1996		213,945	101	214,046
1995		203,251	100	203,351
1994		181,085	185	181,270
1993		171,443	—	171,443
1992		164,342	64	164,406

Note: Contributions were made in accordance with actuarially determined contribution requirements.

The Revitalization Act of 1997 made significant changes to the administration of the Fund. Therefore, comparisons of pre-Revitalization Act information to post-Revitalization Act information may not be meaningful.

**DISTRICT OF COLUMBIA
POLICE OFFICERS AND FIRE FIGHTERS'
RETIREMENT FUND**

Schedule of Investment Information

Year ended September 30, 2001

(Unaudited)

At September 30, 2001, the Fund's investments were maintained under a master trust agreement along with assets of the District of Columbia Teachers' Retirement Fund. A schedule of investments held under the master trust agreement at September 30, 2001 is available for inspection at the offices of the District of Columbia Retirement Board, Suite 300, 1400 L Street, N. W., Washington, D. C. 20005.

**DISTRICT OF COLUMBIA
POLICE OFFICERS AND FIRE FIGHTERS'
RETIREMENT FUND**

Schedule of Five Percent Reportable Series of Transactions

Year ended September 30, 2001

(Unaudited)

Each transaction with State Street Bank and Trust Company as disclosed in this schedule represents a "reportable transaction" as that term is defined by D.C. Code § 1-903.06(b)(3), (2001 Ed.).